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# Appendix 15

## Lender Compliance, Loan Underwriting and Application Processing Deficiency Taxonomy

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### I. Background and Purpose

HUD must manage a variety of risks in the Multifamily Accelerated Processing (MAP) FHA Insurance Program and must maintain an appropriate balance between managing these risks and achieving its mission under the National Housing Act. The MAP Guide, and the regulations and statutes on which it is based, sets forth standards and requirements for all active MAP lenders under the program, as well as the loans they underwrite and applications they submit. By referencing examples of noncompliance and deficiencies from the MAP Guide and identifying their relative severity, this taxonomy gives lenders greater clarity on HUD's risk management process and better advises them of what compliance risks and what loan underwriting or application processing deficiencies may result in sanctions and an enforcement action under Chapter 15 of the MAP Guide.

The bases for issuing a Letter of Caution, a Warning Letter or other sanction are set forth in this Appendix and in sections 15.6 and 15.7 of the MAP Guide. Note that any specific sanctions or enforcement actions will be based on the facts and circumstances of the individual lender's actions or inactions and of the specific MAP transaction.

The taxonomy does not limit HUD's remedies for fraud or misrepresentation in the MAP program or preclude HUD from referring lenders to the MAP Lender Review Board, the Mortgagee Review Board or the Departmental Enforcement Center for noncompliance or deficiencies which, in HUD's judgment, warrant such a referral. Nor does it establish any new standards for administrative or civil enforcement actions, which are currently set forth in law.

## II. MAP Lender Compliance

Chapter 2 sets forth various standards and obligations for lender compliance with MAP program requirements. The list of lender standards and obligations, below, indicates whether a noncompliance is of high or low severity and the likely sanctions for a noncompliance under chapter 15.

A. Instances of lender noncompliance which are of low severity and for which a Letter of Caution may be issued include, but are not limited to:

1. Failure to seek or obtain MACOD's approval for administrative matters requiring its review, including lender change of control, sale, merger or license transfers, as is required by chapter 2.9.
2. Failure to notify MACOD of changes in, or transfers of, key MAP personnel, including MAP approved underwriters and chief underwriters, as is required by chapters 2.11 B & C and 2.13.
3. Failure to notify MACOD of changes in the lender's Quality Control plan, failure to conduct an annual Quality Control review, failure to notify MACOD of the results of the review or to submit an annual QC certification or a transaction tracking report, or failure of the lender to comply with its own Quality Control plan, as is required by chapter 2.10.
4. Material failure to comply with any agreement, certification, undertaking or condition of approval listed in a MAP Lender's application for approval.
5. Failure: a) to respond in a timely manner to inquiries from; b) to comply with any requirement or directive of; or c) to cooperate with an inquiry, review, audit or investigation into the conduct of the MAP Lender, its MAP applications or its FHA insured mortgages by, the Director of OMP, MACOD, the DAS for Multifamily Housing, the MAP Lender Review Board, the Mortgagee Review Board, the Departmental Enforcement Center or the Office of Inspector General.

B. Instances of lender noncompliance which are of high severity and for which a Warning Letter may be issued and Targeted Enforcement Actions or other sanctions may be imposed include, but are not limited to:

1. Identities of Interest or conflicts of interest between the parties to a MAP transaction which are not disclosed to or approved by HUD prior to or during application processing and are discovered after a Firm Commitment has been issued, as is prohibited by chapter 2.7 E.

2. Providing prohibited inducements to a borrower in exchange for their agreeing to engage the lender to process a MAP application, as is prohibited by chapter 2.7 D 7.
3. Payment of referral fees to persons or firms which are not actively engaged in the mortgage origination business and are not mortgage brokers, correspondents or consultants, as is prohibited by chapter 2.4.
4. Payment of refunds or kickbacks to a borrower which are prohibited by the MAP Guide and are not disclosed to HUD, as is prohibited by chapter 2.7 A.
5. Payment by or receipt of a payment by a MAP Lender of any kickback, referral fee or other consideration, directly or indirectly from the sponsor or from any other participant in the transaction, that would affect the lender's independent evaluation or represent a conflict of interest, in connection with any insured mortgage transaction, as is prohibited by chapter 2.7 A.
6. Entering into a side agreement with a borrower or other parties to the transaction which is not disclosed to HUD and is intended to circumvent MAP requirements, as is prohibited by chapter 2.7 D 7.
7. Failure to administer rehabilitation or construction escrow disbursements and site inspections in accordance with the requirements of the MAP Guide, as is required by chapter 2.5 B.
8. Employing or retaining an employee, officer, partner, director, principal or third party firm and who is or will be working on MAP program matters at the time when the person or firm was suspended, debarred, ineligible, subject to an LDP or otherwise prohibited from participation in HUD programs, when the MAP Lender knew or should have known of the prohibition, as is prohibited by chapter 2.7 C.
9. A violation of any Federal Statutes or Regulations or of the requirements of any contract with HUD.
10. Fraud or material misrepresentation on the part of the lender in its participation in any FHA multifamily programs. Note, a lender convicted of fraud may be subject to further action under Public Law 111-22.
11. Indictment or conviction of a MAP Lender or any of its officers, directors, principals or employees for an offense that reflects on the responsibility, integrity or ability of the lender to participate in the MAP program.

### **III. Loan Underwriting or Application Processing Deficiencies**

The MAP Guide has many requirements for lender underwriting and application processing, and it imposes a wide range of responsibilities on the lender. A lender's deficient performance of necessary due diligence or market analysis, or failure to adequately identify, assess and mitigate loan transaction issues and risks, may increase risk to the FHA insurance fund.

HUD will review the quality of the lender's underwriting analysis in the 5 technical disciplines of MAP underwriting, including:

- Borrower mortgage credit and REO analysis under chapter 8
- Valuation and market analysis under chapter 7
- Architectural and cost analysis under chapter 5
- Cash flow analysis of project income and expenses under chapters 3 and 7
- Synthesis of all technical disciplines to evaluate risk under chapter 3

The list of MAP underwriting and processing standards and obligations, below, indicates whether a deficiency is of low or high severity, whether a deficiency will result in referral to MACOD for a lender monitoring review or an enforcement action, and the likely sanctions for a deficiency under chapter 15. For purposes of this Taxonomy, a material underwriting deficiency is an omission or representation by the lender that would significantly alter the underwriting conclusion and result in increased risk to HUD. A significant finding of underwriting deficiencies is a weakness in the lender's risk analysis which the HUD underwriter identified and addressed during processing but which would not alter the underwriting conclusion or result in increased risk to HUD.

- A. Deficiencies in application processing which are of low severity and for which a Letter of Caution may be issued include, but are not limited to:
1. Repeated failure to submit with its applications the required exhibits or certifications, repeated submission of incomplete or inaccurate exhibits or certifications, or inadequate disclosure of material facts affecting the loan application as evidenced by multiple deficiency letters issued to the lender during application processing in response to the missing, incomplete or inaccurate exhibits or certifications or inadequate disclosures.
  2. Identification of 2 or more material underwriting deficiencies in any of the 5 technical disciplines during processing of any single application, or repeated material underwriting deficiencies in any of the 5 technical disciplines for all applications submitted by the lender within any 12 month period, whether or not the lender was notified of the underwriting deficiencies via deficiency letters issued during application processing.
  3. Repeated failure to complete application processing to a Firm Commitment, unrelated to the project underwriting analysis, which demonstrates that the application process should not have been initiated.

4. Failure to notify the HUD processing office promptly of material changes in the application for a Firm Commitment that has been submitted, such as changes in rents, unit count or configuration, or gross project area.
5. Repeated failure to meet MAP closing requirements or construction loan administration requirements.
6. A violation of MAP procedures or requirements by a third party contractor (appraisers, PCNA inspectors, cost analysts, architectural and engineering studies, etc.) that the MAP Lender knew, or should have known, was occurring and that, if performed by the MAP Lender itself, would constitute grounds for sanctions under this Appendix.
7. Submission of an application which is not signed by an authorized MAP underwriter or chief underwriter, as required by chapter 2.11 and 2.5 A, unless the failure to sign the application was inadvertent and the result of an oversight that is immediately corrected.

B. Deficiencies in loan underwriting or application processing which are of high severity and for which a Warning Letter may be issued and Targeted Enforcement Actions or other sanctions may be imposed include, but are not limited to:

1. Any early claims, loan assignments or loan defaults occurring within the first 5 years after Final Endorsement which indicate that the claims, loan assignments or loan defaults were likely due to deficiencies in the lender's loan underwriting and risk analysis.
2. Evidence that a lender's improper, inadequate, inaccurate or negligent underwriting was a likely cause for a serious loan delinquency, default, assignment of an insured mortgage or a claim for insurance benefits to HUD, including a material failure to perform appropriate due diligence and quality oversight over third party contractors.
3. Submission of 2 or more applications within any 12 month period which are subsequently rejected by HUD due to noncompliance with MAP standards.
4. Identification of 3 or more instances of material underwriting deficiencies in any of the 5 technical disciplines during processing of any of the lender's applications within any 12 month period, whether or not the lender was notified of the underwriting deficiencies via deficiency letters issued during application processing.
5. Identification of continued material underwriting deficiencies in any of the 5 technical disciplines during processing of any of the lender's applications within any 12 month period after receipt of a Letter of Caution under Section III A 2, above, whether or not the lender was notified of the underwriting deficiencies via deficiency letters issued during application processing.

6. Issuance of 2 or more Warning Letters within any 24 month period will result in the lender being referred to the MAP Lender Review Board or the Mortgagee Review Board.
  7. Lender collusion with or influence upon third party contractors to modify reports prepared by the contractor that affect the contractor's independent evaluation.
  8. Knowingly submitting false information or a false certification to HUD in connection with any MAP application or mortgage transaction.
  9. Failure to fund an FHA insured mortgage loan or any misuse of mortgage loan proceeds.
- C. Deficiencies in loan underwriting for which the lender may be referred to MACOD for a lender monitoring review include, but are not limited to:

HUD will use the following process to review and assess the quality of a lender's underwriting for each Firm Commitment that has been issued, which review may result in a referral to MACOD for a lender monitoring review under chapter 15.2 C. Each Region will maintain a record which summarizes the HUD underwriter's determinations of any significant findings of underwriting deficiencies in a lender's risk analysis in each of the 5 technical disciplines for all transactions on which Firm Commitment were issued.

HUD will review annually each Region's records for all Firm Commitments issued to the lender during the previous 12 months to identify significant findings of underwriting deficiencies in any of the 5 technical disciplines. HUD will compare the average number of the lender's significant findings in any individual discipline to the average number of significant findings in that same discipline for all lenders which were issued Firm Commitments in that Region during the 12 month review period. Lenders whose average number of significant findings of underwriting deficiencies in any of the 5 technical disciplines were higher than the average number of findings in that discipline for all lenders which were issued Firm Commitments by that Region will be referred by to MACOD for a full or limited lender monitoring review.